

STATE OF MICHIGAN
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES
FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of _____)
Michigan Consolidated Gas Company)
for a Gas Cost Recovery Reconciliation)
proceeding for the 12 months ending)
March 31, 2009.)
_____)

Case No. U-15451-R

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on July 1, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before July 15, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before July 22, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Daniel E. Nickerson, Jr.
Administrative Law Judge

July 1, 2010
Lansing, Michigan
dmp

STATE OF MICHIGAN
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FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On June 29, 2009 Michigan Consolidated Gas Company (Mich Con) filed an application with the Michigan Public Service Commission (Commission) requesting authority to reconcile its Gas Cost Recovery (GCR) revenues and expenses for the 12 month period beginning April 1, 2008 and ending March 31, 2009. Along with its application, Mich Con filed testimony of four witnesses and related exhibits.

On August 27, 2009 a prehearing conference was held before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). Petitions for Leave to Intervene were filed by the Attorney General of the State of Michigan (AG), the Residential Ratepayers Consortium (RRC) and Michigan Community Action Agency Association (MCAAA). At the prehearing, Mich Con was represented by attorneys Richard P. Middleton and David S. Maquera; the AG was represented by Assistant Attorney General Michael E. Moody;

the RRC was represented by attorney David L. Shaltz; and MCAAA was represented by attorney Don L. Keskey. Commission Staff (Staff), through its appearance, was represented by Assistant Attorney General Spencer Sattler. Intervention was granted to the AG, the RRC and MCAAA. A schedule was set for the remainder of the case.

On April 13, 2010 an evidentiary hearing was held. Mich Con presented the testimony of its four witnesses W. Bernard Kramer, Jennifer C. Schmidt, Eric W. Clinton, and Barbara J. Goodwin. The AG presented the testimony of Ralph E. Miller. The RRC presented the testimony of Frank J. Hollewa. MCAAA presented the testimony of Geoffrey C. Crandall. Staff did not present a witness.

On May 11, 2010 initial briefs were filed by Mich Con, the AG, the RRC, MCAAA, and Staff. On May 25, 2010 reply briefs were filed by Mich Con, the AG, the RRC, and MCAAA. Staff elected not to file a reply brief.

The record consists of two volumes of transcripts totaling 297 pages and 40 exhibits admitted into evidence.

II.

STATUTORY REQUIREMENTS

Subsection 6h(12) of 1982 PA 304 [MCL 460.6h(12)] requires that not less than once a year and not later than three months after the end of the 12-month period covered by a gas utility's gas cost recovery plan, the Commission shall commence a gas cost reconciliation proceeding as a contested case pursuant to Chapter 4 of Act 306 of the Public Acts of 1969. At the gas cost reconciliation, the Commission shall reconcile the revenues recorded pursuant to the GCR factor and the allowance for cost

of gas included in the base rates established in the latest Commission order for the gas utility with the amounts actually expensed and included in the cost of gas sold by the utility. The section further provides that the Commission shall consider any issue regarding the reasonableness and prudence of expenses for which customers are charged if the issue could not have been considered adequately at a previously conducted gas supply and cost review.

Subsection 6h(13) of 1982 PA 304 [MCL 460.6h(13)] provides that in its order in a gas cost reconciliation, the Commission shall require a gas utility to refund to customers or credit to customers' bills any net amount determined to have been recovered over the period covered in excess of the amounts actually expensed for gas sold, and to have been incurred through reasonable and prudent actions not precluded by Commission order in the gas supply and cost review.

Subsection 6h(14) of 1982 PA 304 [MCL 460.6h(14)] provides that in its order in a gas cost reconciliation, the Commission shall authorize a gas utility to recover from customers any net amount by which the amount determined to have been recovered over the period covered was less than the amount actually expensed by the utility for gas sold, and to have been incurred through reasonable and prudent actions not precluded by Commission order in the gas supply and cost review. The subsection further provides that for excess costs incurred through actions contrary to the Commission gas supply and cost review order, the Commission shall authorize the recovery of costs incurred for gas sold in the 12-month period in excess of the amount recovered over the period only if the utility demonstrates by clear and convincing evidence that the excess expenses were beyond the ability of the utility to control

through reasonable and prudent actions. Also, for excess costs incurred through actions consistent with the Commission's gas supply and cost review order, the Commission shall authorize the recovery of costs incurred for gas sold in the 12-month period in excess of the amount recovered over the period only if the utility demonstrates that the excess expenses were reasonable and prudent.

Subsection 6h(15) of 1982 PA 304 [MCL 460.6h(15)] provides for the methodology and calculation of interest if the Commission orders refunds or credits pursuant to Subsection (13) or additional charges to customers pursuant to Subsection (14) in its final order in a gas cost reconciliation.

III.

DISCUSSION

Legal and Regulatory Action

Mr. Kramer testified regarding Mich Con's involvement with regulatory events and regulatory actions in efforts to minimize costs from its interstate pipeline transporters including rate-related applications at the Federal Energy Regulatory Commission (FERC). Mich Con also monitored rulemaking proceedings and followed other FERC and National Energy Board of Canada activity. In particular, Mich Con participated in ANR's proposed new fuel rates for transportation, recovery of the cost for electric compression, and recovery of gas losses attributable to Hurricane Ike. Mich Con asserts that its involvement resulted in reduced ANR fuel rates for transportation.

System Operations

Mich Con presented testimony by Ms. Goodwin to explain its actual operations for the April 2008 to March 2009 operational year (OY). Ms. Goodwin compared Mich Con's actual operations with its projected operations as filed in the plan case as modified and amended in *MPSC Case No. U-15451*¹.

Ms. Goodwin testified that during the OY it adjusted its operational plan for changes in forecasted weather, customer migration², inventory variances, supply variances, lost gas variances, and the impact of customer load losses. 2 Tr 55. Ms. Goodwin testified that throughout the OY, Mich Con constantly, as least monthly, updated its supply plan to reflect actual activity and changes to forecasted activity. Ms. Goodwin sponsored Exhibit A-11 which graphically shows a comparison between Mich Con's GCR plan supply purchases and actual purchases.

Ms. Goodwin testified concerning the weather conditions for the OY. She stated that the summer weather was 14.0% warmer than normal and the winter weather was 4.4% colder than normal. Weather for the entire OY was 0.6% colder than normal. Exhibit A-12 line 35, column I. Ms. Goodwin testified that Mich Con was able to adjust to various weather variations by adjusting purchases and also through its supply planning process as identified in its plan.

Ms. Goodwin explained the storage levels of gas supply. Mich Con began the OY in April 2008 with gas storage levels about 0.5 Bcf below the planned level. At the end of April storage was 2.5 Bcf above planned levels due to a near record warm April. Over the summer, MichCon continued to adjust its planned supply purchases so that at

¹ The Commission Order dated August 26, 2008 approved a partial settlement agreement.

² Customer migration occurred between GCR customers and Gas Choice customers.

the end of the injection season the storage balance was 71.6 Bcf or 0.4 Bcf above the planned level. 2 Tr 58.

Mich Con's storage withdrawals were 59.9 Bcf or 3.1 Bcf less than the Plan level of 63.0 Bcf for November 2008 through 2009. Exhibit A-12, column F, line 25. Due to 11% colder than normal weather, withdrawals exceeded planned levels by 4.6 Bcf for November through January. Mich Con withdrew 7.7 Bcf less storage supply for February and March due to warmer than normal weather. Mich Con also purchased 1.7 Bcf in March 2009 due to a favorable pricing opportunity. At the end of the OY, storage level was at 11.8 Bcf or 3.6 Bcf above the planned level of 8.2 Bcf. 2 Tr 59.

Exhibit A-12 shows Mich Con's planned operations compared with its actual operations. Under the subcategory disposition, Exhibit A-12 shows total sendout was 2.6 Bcf below plan levels. Mich Con attributes the decline in usage due to relatively high gas prices and current poor economic situations leading to customer conservation, increased gas theft and foreclosures. Mich Con notes that the increased volumes lost by gas theft were offset for plan purposes by lower GCR and GCC sendout.

Mich Con ended the winter operating season with 11.8 Bcf of gas in storage representing 3.6 Bcf more gas in storage than the planned level of 8.2 Bcf. Mich Con explains that the higher level of storage was largely attributable to lower sales due to the warmer than normal weather in March 2009. Mich Con, as noted above, purchased 1.7 Bcf of additional supply in March 2009 because it found price signal indicators showing that it would be less expensive to buy in March 2009 than during the summer of 2009.

In March 2009, Mich Con also made the second purchase of MGAT gas. The MGAT purchases were not included in Mich Con's filed GCR plans. Ms. Goodwin testified that the MGAT purchases replaced purchases Mich Con would have otherwise made. The MGAT volumes were included in Exchange Gas deliveries during the Plan year and were already included in the GCR storage inventory by March 2009. 2 Tr 65-66.

Natural Gas Markets

During the OY, Mich Con faced some of the highest natural gas volatility in the history of the natural gas markets. The NYMEX monthly spot contract prices varied by as much as \$9.049 per Mcf. NYMEX intraday trading also showed historical levels of volatility with a low of \$3.600 per Mcf on March 27, 2009 and a high of \$13.694 per Mcf on July 2, 2008.

National storage levels were reported at an increase of 5 Bcf above the five-year average at the end of March 2008. Nationally, supply exceeded demand for the OY. This resulted in an average increase in storage of about 406 Bcf at the end of March 2009. During the injection season, NYMEX prices were extremely volatile. From April 1, 2008 to July 2, 2008, prices rose 41% from \$9.724 per Mcf to \$13.694 per Mcf. This increase was considered to be the result of high oil prices, low liquefied natural gas imports, consumption growth and a decline in working inventories. Prices began to drop precipitously from the peak to a low of \$5.990 per Mcf on October 27, 2008. This represented a decline of 56% in four months. This decrease was considered to be the result of lower oil prices, increasing domestic production and uncertainties about future economic growth. NYMEX prices continued declining during the winter season from

October 31, 2008 to March 31, 2009 for a price of \$3.776 per Mcf. This decline was considered the result of supply far exceeding demand due to the economic downturn.

The 2008 hurricane season with activity well above average levels also affected gas prices. Two hurricanes had a direct negative affect on gas production in the Gulf – Hurricanes Gustav and Ike. Production dropped from 6.9 Bcf per day to 2.2 Bcf per day. Production rebounded to 5.9 Bcf per day by mid-December 2008. These two hurricanes also caused significant damage to offshore production facilities, causing numerous shut-ins. Despite the significant damage and loss of production in the Gulf, Mich Con experienced only 159,994 Mcf of supply losses due to hurricanes. This represents less than 0.10% of Mich Con's annual gas purchases.

Supply Pricing

Mich Con used the following four types of fixed price methods:

1. Long-term quartile index method (QIM)
2. Short-term 21-day moving average (21-DMA)
3. Short-term benchmark price method (Benchmark)
4. Short-term 40% prompt winter supply milestone default method (Winter Supply).

Mich Con acquired the following volumes of gas at the average prices using the above fixed price methods as shown in Exhibit A-2:

<u>Method</u>	<u>Volume</u>	<u>Average Price</u>
QIM	47.9 Bcf	\$7.602 per Mcf
21-DMA	10.9 Bcf	\$8.707 per Mcf
Benchmark	11.8 Bcf	\$5.447 per Mcf ³
Winter Supply	5.3 Bcf	\$11.89 per Mcf

The prices that Mich Con paid for all of its fixed price purchases exceeded the prices in published monthly indices by about \$1.486 per Mcf. Mich Con points out that

³ At a benchmark price of \$7.177 per Mcf

even so, at the time of the purchases, there was absolutely no certainty as to future prices settling lower. Mich Con further states that there were no intervening factors that suggested that Mich Con should have deviated from its Commission approved fixed price guidelines. 2 Tr 109. Mr. Clinton testified that Mich Con was able to insulate its GCR customers from the price volatility by following its approved fixed price supply plan.

Mich Con fixed basis purchases were about 4.6 Bcf or 2.9% of the total acquired supply. MichCon explains that this was below the 20-25% approved in the settlement agreement. Mr. Clinton further explained that overall the fixed basis purchases were only \$0.08 per Mcf more than the monthly index price. 2 Tr 111. The remainder of Mich Con's supply, about 76.3 Bcf was purchased using monthly market-based index pricing.

Over the OY, Mich Con's supply mix was 49.1% fixed price, 2.9% NYMEX +/- Fixed basis and 48.0% Index/Spot. Mich Con asserts that this supply mix provided pricing diversity and balance which assisted in insulating customers from volatile market prices. Mich Con's total cost of gas associated with its purchases was \$1,357.9 million an average purchase cost of \$8.93 per Mcf. 2 Tr 113. Mich Con exceeded the plan purchase level by 1.8 Bcf at a cost of about \$110 million. Mich Con provides, by way of explanation, causes for the purchases to have exceeded the plan levels: 1) Higher oil prices caused indexed-price supplies to cost \$88 million more than planned, 2) It cost about \$14 million more than plan prices to convert about 26 Bcf of index-priced supplies to short-term fixed prices to comply with the fixed price guidelines, 3) The additional purchase of 1.7 Bcf in March 2009 at prices lower than summer 2009 prices which also spread the risk throughout the March 2009 to October 2009 period, 4) Actual transportation costs were about \$3 million higher than planned. 2 Tr 113-114.

Interstate, Intrastate and Canadian Purchases and Transportation Costs

Mich Con's total interstate, intrastate, and Canadian purchases for the GCR period are as noted below⁴:

<u>Purchase</u>	<u>Actual Volume</u>	<u>Plan Volume</u>	<u>Actual Cost</u>	<u>Plan Cost</u>
Interstate	90.0 Bcf	99.4 Bcf	\$780.2	\$781.5
Intrastate	15.2 Bcf	4.2 Bcf	\$125.3	\$35.2
Canadian	46.9 Bcf	46.7 Bcf	\$390.4	\$371.2

For the GCR period, Mich Con included \$63.5 million for transportation costs. The total transportation cost was about \$3.2 million more the plan estimate. Mich Con attributes the increased transportation cost as a result of the weakness of the United States dollar as compared to the Canadian dollar.

Affiliate Purchases

The central issues which are disputed in this case involve proposed disallowances and proposed future restrictions on Mich Con's purchases of gas from its affiliates DTE Energy Trading (DTE ET) and Mich Con Gathering Company (MGAT). Mich Con made several purchases from its affiliated companies during the GCR period. The Mich Con affiliate purchases during the GCR plan period are identified below:

<u>Affiliate</u>	<u>Purchased Volume</u>	<u>Total Cost in Millions</u>
DTE ET	3.3 Bcf	\$24.4
MGAT	0.8 Bcf	\$6.3
MGAT	1.0 Bcf	\$8.7

The AG proposes two disallowances related to Mich Con's gas supply purchases from affiliates. The AG proposes a disallowance in the amount of \$59,781 related to the DTE ET purchases and \$1,124,977 related to the MGAT purchases. In addition to the

⁴ 2 Tr 116-117.

proposed disallowances, the AG recommends several controls which would apply prospectively to Mich Con's affiliate purchases to guard against what it calls "self-dealing".

The AG argues that transactions with affiliates, wholly owned or partially owned, deserve additional scrutiny because of the potential and incentive for self-dealing. The AG relies, in part, on *MPSC Case No. U-10150*, dated December 8, 1992 as support that the Commission has recognized this same concern. The AG argues that under Act 304 review, an examination of affiliate transactions is an important and central requirement.

Mr. Miller highlighted the AG's position in his testimony. He testified:

Purchases from affiliates are important for (at least) two reasons that I have identified. One is that they present a possible opportunity for MichCon to abuse the GCR process by paying an inappropriately high price to its affiliates and then recovering the inappropriately high purchase costs from its customers. The second reason is that MichCon's purchases from affiliates may create a financial incentive for MichCon to incur higher costs for its other purchases, which is a financial incentive for MichCon to inflate – or at least fail to try to control or minimize – its total cost of purchased gas. 2 Tr 243.

Concerning the financial incentive for Mich Con to incur higher costs for its other purchases, Mr. Miller testified:

This perverse financial incentive affecting all of MichCon's other purchases is, paradoxically, a consequence to the regulatory concern about the first problem, which is the possibility that MichCon may be paying too high a price for gas it purchases from its affiliates. To avoid the appearance of impropriety, MichCon seeks to justify the Reconciliation Period prices it paid to its affiliates by showing that those prices are no higher than the prices charged or offered by unaffiliated sellers. But if that justification is accepted without question, then MichCon has a financial incentive to pay higher prices for its purchases from unaffiliated sellers, thereby providing itself with a higher benchmark for pricing of its purchases from its affiliates. 2 Tr 243-244.

MCAAA also asserted concerns regarding affiliate purchases. MCAAA sponsored the testimony of Mr. Crandall. Mr. Crandall testified:

My concern is that the purchases made by MichCon from its two affiliates has not been shown to be necessary. I also have concerns regarding the lack of information provided by MichCon in its filing to substantiate that the transactions and purchases were reasonable and prudent. This is particularly important since the protections normally existent in arms length transactions were absent in these purchases. MichCon purchases from its affiliates have not been shown to be reasonable and prudent. MichCon should provide far more information to demonstrate the prudence and reasonableness of their decisions...

Additional information regarding the sensitive nature of transactions with MichCon's own affiliate companies has not been provided. I acknowledge that Witness Chapel sponsored Exhibit A-10, entitled "Affiliate Purchase Summary", which is a summary of affiliate transactions. However, that is insufficient proof of the reasonableness and prudence of the affiliate transactions.⁵ 2 Tr. 289-290.

Mich Con responds that there is not any factual basis presented by either the AG or MCAAA to show any abuse of the GCR process through its affiliate transactions. On the other hand, Mich Con asserts that it has presented evidence which substantiates the reasonableness of the pricing of its supply purchases from its affiliates. Mich Con states that Exhibit A-10 shows comparable prices offered to Mich Con by unaffiliated suppliers for the same product on the same day.

Mich Con paid a premium over the purchase price in some of the supply purchased and shown on Exhibit A-10. Mich Con argues that the fact that a price exceeds index is not proof that it is unreasonable or imprudent most of its index purchases include a premium index. In fact, over 85% of its indexed purchases in the past have included a premium. 2 Tr 125-126. Mr. Clinton explained why Mich Con pays a premium above the published index price. Mr. Clinton testified that marketers

⁵ The issue regarding Mich Con providing more information is addressed later in this PFD.

and producers assign a premium or discount to index purchases based on the amount of supply available at a specific location. Mich Con determines whether a premium or discount is fair or represents the market price based on other suppliers' offers which Mich Con has in hand or recent purchases for the same product. Mr. Clinton states that premiums are not desirable and the buyers will attempt to minimize the premium or maximize the discount. However, if the market requires a premium and Mich Con must acquire supply then the premium is paid. 2 Tr 126-127.

Staff disagrees with the proposed disallowances offered by the AG and MCAAA. Staff asserts that Mich Con's DTE ET purchases were appropriate because the prices paid were all reasonably close to the market price at the time of the purchases. 2 Tr 125, Exhibit A-10.

The ALJ concurs with Mich Con and Staff concerning the evidence presented regarding the affiliate purchases. The ALJ finds that while the AG and MCAAA arguments are strong and reflect, to some extent prior Commission concerns as stated in *MPSC Case No. U-10150*, dated December 8, 1992, pp 5-6, there has not been presented any evidence to support the arguments and concerns. On the other hand, Mich Con has presented testimony and exhibits which show that the affiliate purchases were close in price to the market prices. The ALJ finds that this evidence supports a finding that the affiliate transactions were reasonable and prudent.

In making this finding, the ALJ is keenly aware of Mr. Miller's testimony concerning the lack of evidence. Mr. Miller readily admits that he has no evidence to support his position. The ALJ finds this testimony intriguing because of the contradicted arguments offered by Mich Con and the AG resulting from the admitted lack of

evidence. Mich Con argues that Mr. Miller has no evidence, no proof and as such the concerns should be dismissed. However, the AG argues that, in essence, the nature of an affiliate transaction coupled with the prices actually paid speak for themselves in terms of the reasonableness of the purchases. Mr. Miller testified:

No, I do not (have evidence), and that is precisely the point of my concern about removing the financial incentives for MichCon to give preferences to its affiliates. Except in egregious cases of abuse, it is impossible for the Commission to detect abuses of the type I have described. That is precisely the reason it is so important for the Commission to remove the perverse financial incentive of allowing MichCon to purchase gas from its affiliates at prices reflecting MichCon's costs for its purchases from unaffiliated suppliers. 2 Tr 247. Text in parentheses has been added.

The ALJ is also keenly aware of the nature of the contested case proceeding. The contested case requires evidence to support a position. On this point, the ALJ finds that Mr. Miller's testimony is worthy of further reflection as it relates to the nature of the affiliate purchases and the admitted lack of evidence. The ALJ believes Mr. Miller's admission of the lack of evidence, though legally detrimental to their position, underscores of the necessity of the need to address affiliate transactions. The ALJ finds that the arguments raised by the AG and MCAAA strike strong rationale in an intuitive sense regarding possible abuses of affiliate transactions. While, the contested case proceeding works well for its intended purpose, it requires evidence. Strong rationale regarding possible abuses is insufficient basis in a contested case proceeding⁶.

MCAAA is concerned with the MGAT purchases involving Mich Con paying MGAT for gas which was actually delivered in the prior 12-month Plan and reconciled in this case. MCAAA points to Ms. Goodwin's testimony as an admission that the subject

⁶ Further discussion regarding affiliate purchases may be found under the heading Proposed Future Restrictions on Affiliate Purchases in this PFD.

deliveries were delivered in a prior period. Ms. Goodwin admitted that MGAT supply was delivered in the April 2007 through March 2008 period. 2 Tr 155-156.

Mich Con responds that MCAAA's concern is unfounded and represented a lack of understanding with respect to this aspect of the GCR process. Mich Con explains that the lost and unaccounted for gas is already subtracted for its purchase of gas.

Exhibit A-18, p. 2 line 8. Further, Ms. Schmidt elaborated:

Well, there was no delay between the time those deliveries were made and the time that the cost was recorded. At the time each of the monthly deliveries is made and determined, at that time MichCon looks at exchange gas and books a corresponding cost to that volume. Those actually were included in the year that the deliveries were made. The only dollars that were reflected on this year was the actual transaction. The impact on the plan year on U-15451-R was a net zero impact. 2 Tr 200.

The ALJ agrees with Mich Con. Lost and unaccounted for gas is included in the gas recovery clause for the current GCR period. This case represents the reconciliation of the cost of the lost and unaccounted for gas. As Ms. Schmidt testified there is a net zero impact. The ALJ recommends that the Commission reject MCAAA's proposed disallowance.

MCAAA argues that Mich Con made forced gas purchases in June 2008 costing \$62.6 million which should have cost about \$35 million less. MCAAA witness Mr. Crandall testified as to the reason that these June 2008 purchases were called forced purchases. Mr. Randall states:

Because MichCon failed to have 40% of its November – March flowing gas requirement locked in fixed price contracts by July 1, it forced a purchase of five percent of the winter volume at the end of June. 2 Tr 292.

Mr. Crandall testified that as a result of Mich Con's concentrated purchases in a span of five days, especially at a time when gas prices were near record highs,

“MichCon’s strategy resulted in higher gas costs.” 2 Tr 292. Mr. Crandall explains that if Mich Con had purchased gas supply over a longer period of time using dollar cost averaging the costs savings could have been about \$35 million.

Mr. Crandall rejects Mich Con’s claims that it was simply following its GCR plan. Mr. Crandall indicates that according to the GCR plan, Mich Con should have had 35-40% of its flowing prompt winter gas under fixed prices by July 1. Mich Con only had 35% by July 1 and as such needed to purchase the remaining 5%. MCAAA argues that a rate adjustment of \$35 million is appropriate relative to these forced gas purchases.

Mich Con argues that its purchases were consistent with its Commission approved fixed price guidelines. Mich Con criticizes Mr. Crandall’s testimony as the result of impermissible hindsight. Mich Con argues that MCAAA’s argument involves a tortured interpretation of the guidelines. Mich Con asserts that while following the guidelines, it purchased competitively priced supply in a reasonable and prudent manner.

The ALJ concurs with Mich Con. The Commission-approved Fixed Price Guidelines state:

MichCon will, during the last 5 trading days of the July NYMEX contract, lock-in fixed prices on the Balance of Period volume sufficient to achieve 40% of its flowing November through March supply under fixed prices. Section 8.2.b.

During the last 5 trading days of the June NYMEX contract, [MichCon shall] lock in fixed prices on the Balance of Period volumes sufficient to achieve 35% of its flowing November through March supply under fixed prices. Section 8.2.a.

The ALJ finds that based on the language of sections 8.2.a and b, Mich Con’s purchases were consistent with the provisions of the guidelines. There has been no showing that the purchases were non competitive or that the purchases were not

prudent. The purchases only involved 5% of Mich Con's total supply purchases. Even though Mich Con was at the outer limit of the guideline, Mich Con was nonetheless still within the parameters of the guideline. The ALJ recommends that the Commission reject the MCAAA's propose disallowance in the amount of \$35 million.

Jurisdictional Rate

The AG argues that it is inappropriate for Mich Con to pay its jurisdictional rate to MGAT for its supply purchases. The AG argues that it is appropriate for the city-gate index price to be paid for MGAT supply purchases. The AG argues that the nature of the supply provided by MGAT is significantly different than the supply provided under fixed supply contracts. The AG points out that under fixed price contracts the seller is required to deliver a specified quantity of secure supply at a specified future date. The AG notes that part of the value of a fixed price contract is the security. The AG argues that it would be unreasonable and unjust to pay MGAT a price reflecting the supply security of a fixed price contract especially when MGAT cannot offer the same advantages as a fixed price contract in particular security.

The AG explains that most of Mich Con's jurisdictional rate is calculated using fixed price contract supplies. 2 Tr 260-261. MGAT supply, argues the AG, is very much different in character from the supply used in calculating the jurisdictional rate. The AG also points out that there is not any contractual basis or other foundation for the use of the jurisdictional rate for the MGAT supply purchases. The AG disagrees with Mich Con that an adequate basis may be found in past practices. The AG argues that the MGAT situation has changed dramatically since the practice of settling gains and losses was established. The most recent important change is that Mich Con just

recently began making purchases from MGAT, in essence sometime in March 2007.

The AG also argues that in the past there has been both gains and losses to be balanced. However for the past three years there appears to have been only gains. So it is appropriate to take a fresh look at pricing MGAT supply and for settling gains and losses.

The RRC also proposes pricing the MGAT supply purchases at the city-gate index. Mr. Hollewa testified that the purchase at the city-gate index (market price) rather than the jurisdictional rate would cost less and would reduce the jurisdictional rate. 2 Tr 225-226. Mr. Hollewa explains that even though Mich Con does not directly benefit from the difference between the market price and the jurisdictional rate, Mich Con's affiliate benefits at the expense of the GCR customers. Again, he states that this is because the jurisdictional rate would be at a higher cost than the market rate. 2 Tr 226.

Staff proposed to apply the city-gate index as a ceiling for MGAT supply purchases on a going forward basis. Staff also recognizes the unreliability of the MGAT supply. It notes that Mich Con doesn't know how much or when it will receive the gas until after it has been delivered. 2 Tr 138. However, Staff would not apply any disallowance as a result of changing the approved price for the MGAT purchases in this case. Staff believes that it would be unfair to Mich Con since there was not any notice that the Commission would use some other benchmark for the MGAT supply rather than the jurisdictional rate. Staff notes that Mich Con has been charging the jurisdictional rate for MGAT supply since 2005 without any objections.

Mich Con argues that the MGAT purchases have been priced at the jurisdictional rate, included and approved by the Commission in past GCR reconciliations. Mich Con notes that the practice was established at least nine years ago from an even older practice of pricing imbalances in physical deliveries at key points. However, Mich Con does not oppose Staff's recommendation. Mich Con further notes that prospective application of the city-gate index should also apply to MGAT supply purchased booked after the issuance of the Commission order in this case. This is due to monthly MGAAT imbalances occurring in subsequent GCR periods which have not yet been subject to reconciliation.

The ALJ finds that the MGAT supply purchases are different in character than the fixed contract supply. The MGAT supply is indisputably less reliable. As such, the application of Mich Con's jurisdictional rate which is calculated based mostly on fixed contract rates reflects the value of a more reliable supply. The ALJ finds that the evidence overwhelmingly supports the application of the city-gate rate as the more appropriate benchmark for MGAT supply.

The ALJ further recommends that the Staff's recommendation regarding pricing the MGAT purchases prospectively (not in this case) is reasonable. The Commission order approving the city-gate benchmark would definitely place Mich Con on notice. However, in making this recommendation the ALJ rejects Mich Con's request that it not apply to MGAT supply booked but not approved in forthcoming GCR periods. The ALJ finds that the AG has shown that Mich Con was aware of the potential risk of GCR disallowance of the practice. Exhibit AG-8. Moreover, the ALJ looks again to the overwhelming weight of the evidence that the application of the city-gate index is more

appropriate. Mich Con has not presented any substantial evidence or argument for continuing the practice in future cases. The ALJ further notes that the GCR customer pays this expense to the benefit of Mich Con's affiliate. There has been no showing that under these circumstances the practice should continue after this case.

Proposed Future Restrictions on Affiliate Purchases

The AG proposed two controls for the Commission to apply to protect GCR customers from affiliate self-dealing. The AG argues that since Mich Con does not use a formal RFP or other competitive solicitation process for its commodity gas purchases, the affiliate transactions are not transparent. Mr. Miller testified that the process is not transparent because it is rather informal in nature. Mich Con contacts a few suppliers by phone for bids and then it may accept some of none of the bids. 2 Tr 250.

The AG's proposed restrictions are:

1. Limit the allowable quantity of purchases from Mich Con's affiliate to 1% to 1.5% of Mich Con's total purchases from all sources. Any deviation from this limitation would require Commission approval in advance.
2. Limit recovery to the city-gate index rate as a maximum rate for any purchases from Mich Con's affiliates. Mich Con would still be required to show that the price paid to the affiliate is at least as favorable as the best offer available from an unaffiliated seller.

Mr. Miller testified in support of these proposed two controls. Mr. Miller states:

A quantity cap is important because the Commission cannot detect and therefore cannot prevent (or remedy) all of the ways MichCon can favor its affiliates in the purchase of natural gas, not even with the price cap that I have recommended. The imposition of a quantity cap serves to limit the amount of excess cost that MichCon can incur by purchasing gas from its affiliates. More important, if the Commission imposes a quantity cap in addition to a price cap, as I am recommending, the combination may dissuade MichCon from looking to provide opportunities for it to make purchases from affiliates on terms favorable to the affiliates. This combination would thus leave MichCon with no perverse financial

incentive to refrain from minimizing its total purchased gas costs. 2 Tr 249.

Mich Con is opposed to the AG's request to place a 1% to 1.5% cap on affiliate purchases. Mich Con argues that the record contains no valid rationale for a supply cap. Mich Con argues that it has in place internal and external oversight, procedures, policies, regulations, codes of conduct, standard work instructions, training, compliance and ethical standards, all of which it follows in the conduct of its business. Mich Con argues that these controls prevent affiliate abuse. Moreover, Mich Con argues that where an affiliate is able to offer competitively priced supply, Mich Con should take advantage of this supply opportunity. Mich Con views such constraints as unnecessarily limiting supplier diversity and competitive pricing. Mich Con contends that such restrictions are arbitrary limitations which would be unfair, prejudicial, discriminatory, and potentially more costly to GCR customers. 2 Tr 128-129.

Mich Con argues that Exhibit A-10 shows all of the purchases from DTE ET and that those purchases were less than or equal to comparable purchases from other suppliers during the contemporaneous time periods. Michigan Con does not understand what more information it could make available except possibly the basis for choosing the affiliate supplier.

Staff does not agree with the AG's proposed future restrictions on affiliate purchases. Concerning the AG's first proposed restriction, Staff distinguishes the MGAT supply purchases, which it agreed should be priced at the city-gate index, as different from other Mich Con affiliate purchases. In the case of MGAT, Staff explains that Mich Con agreed to accept all the MGAT imbalances because it is an affiliate. Staff states that because Mich Con did so it would be fair to apply the monthly city-gate index

to these purchases. However, Mich Con has no such agreement with its other affiliate. Staff concludes that there has not been any persuasive reason to limit other affiliate transactions to the city-gate index price at this time.

Staff argues that it would be a mistake to cap affiliate transactions at 1% or 1.5% for Mich Con's total gas supplies. Staff is of the opinion that Mich Con should be able to obtain competitive priced supply from an affiliate. It should not be restricted from an affiliate purchase simply because it has met an artificial cap on affiliate purchases thus creating an inefficient market. 2 Tr 129. However, Staff requests that the Commission require Mich Con to provide additional information in future reconciliations to verify that its affiliate purchases were in the CR customers' best interest. Specifically, Staff requests a list of all the producers Mich Con solicits bids from, those producers' quoted prices, Mich Con's affiliates' prices and the reason Mich Con chose to purchase from its affiliate.

The ALJ recognizes that there has not been any showing that Mich Con abused the GCR process through its affiliate purchases. There has not been a showing that Mich Con benefited its affiliate at the expense of the GCR customer. While there was a finding that Mich Con should apply the city-gate index to its MGAT purchase rather than the jurisdictional rate, the finding is more reflective of the nature of the distinction between the supply provided by MGAT versus the nature of the supply purchased at fixed contract rates.

The ALJ is reluctant to recommend any limitations on Mich Con's affiliate purchases where, as here, there has been no showing of abuse. Absent such a finding, the ALJ believes that he should not recommend any limitations on Mich Con's affiliate

purchases. The ALJ makes this finding with some concern. Mich Con has pointed out the internal and external oversight, procedures, policies, regulations, codes of conduct, standard work instructions, training, compliance and ethical standards which it asserts prevents affiliate abuses. However, the specifics of these internal and external controls have not been addressed in this case in a manner which results in any meaningful recommendation regarding the effectiveness of these controls at regulating affiliate abuses. Even though the ALJ does not recommend any of the proposed future restrictions, that is not to say that there should not be any. The testimony of Mr. Miller and Mr. Crandall make a strong case to the effect that there should, in fact, be very specific and particularized regulations governing affiliate transactions. The findings of the ALJ concerning future restrictions are limited only to the evidence and arguments presented in this case. These things said, the ALJ remains of the opinion that without a showing of affiliate abuse or affiliate transactions which benefit an affiliate at the expense of the GCR customer, he cannot recommend any of the proposed restrictions at this time.

Staff, the AG and MCAAA have requested that Mich Con submit more information regarding affiliate purchases. However, there have not been any specificity related to the requests for more information on affiliate transactions, other than as set forth by Staff. The ALJ finds that Mich Con provided the essence of Staff's request for more information. The one item Mich Con did not provide was the specific reason why it chose the affiliate over other suppliers. The ALJ finds that as it relates to Staff's specific request, Mich Con need only include the reason for choosing the affiliate to have fulfilled Staff's request. The ALJ recommends that Mich Con submit information

as requested by Staff including the reason for selecting the affiliate in future cases. As it relates to other unspecific requests for more information, the ALJ withholds any recommendation pending the submission of more specificity.

IV.

CONCLUSION

The ALJ recommends that the Commission approve Mich Con's request for reconciliation of its GCR cost of gas sold for the 12-month period ending March 31, 2009. The ALJ recommends the calculations of interest from the prior period as set forth by Mich Con. The ALJ recommends that the city-gate rate is the appropriate rate for the MGAT supply purchases rather than the jurisdictional rate. The ALJ makes further findings as noted above concerning proposed restrictions on affiliate purchases.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Daniel E. Nickerson, Jr.
Administrative Law Judge

July 1, 2010
Lansing, Michigan
dmp